

Old Colony Law

Five Firewalls: Asset Protection for Business Owners

In an increasingly litigious world, business owners should be concerned about protecting their personal assets from claims by creditors, including customers, vendors, employees and competitors. Here are five legal firewalls business owners can construct to help protect against lawsuits and other financial disasters.

CORRECT USE OF BUSINESS ENTITIES

Operating your business as a corporation or limited liability company (LLC), as opposed to a general partnership or sole proprietorship, protects your personal assets from business-related contractual disputes, personal injury claims or cyber theft of customers' financial information.

After establishing your business entity, you must take certain steps, generally known as "corporate formalities," to maintain personal asset protection associated with conducting your business through an entity:

- ✓ Hold annual shareholder, director or member meetings
- ✓ Follow and keep records of corporate bylaws and operating agreements
- ✓ Elect directors, officers or managers as prescribed in the bylaws or operating agreement
- ✓ Avoid commingling of personal and business accounts
- ✓ Keep accurate accounting records
- ✓ Make annual filings with the Massachusetts Secretary of State
- ✓ Maintain a record book of business documents, meeting minutes, shareholder and director resolutions, leases and major transactions

Massachusetts courts have allowed creditors to "pierce the corporate veil" and reach a business owner's personal assets for debts incurred in connection with the business. In determining whether to allow this to happen, courts look to a number of factors, including whether corporate formalities have been observed. Therefore, failure to follow these corporate formalities may be an invitation for creditors to attach their interests to your personal assets.



Claire Crowley

Attorney (Massachusetts & New Hampshire)

Western Massachusetts

978 519 0370

Ben Palkowski

Attorney, CPA (Massachusetts)

North Shore

413 387 0080

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CREATIVE ESTATE PLANNING

Strategic allocation of a married couple's assets between the two spouses may also help protect those personal assets from business-related claims. An important and creative estate planning technique is to divide a married couple's assets, to the extent practicable, between them in order to take full use of both spouse's estate tax exemptions. This allocation of assets provides an opportunity to put at-risk assets in the name of the non-business owner spouse and assets unreachable by creditors in the name of the business owner spouse. Then, once at-risk assets are in the name of the non-business owner spouse, creative estate planning allows for such assets to be held in an asset protection trust for the benefit of the business owner spouse should the non-business owner spouse die before the business owner spouse.

RETIREMENT ACCOUNTS

Any small business owner should, as part of comprehensive personal asset-protection planning, to the extent practicable, fully fund retirement accounts, such as Individual Retirement Accounts (IRAs), Simple Employee Pensions (SEPs), 401(k) plans and Defined Benefit Plans. Assets placed in retirement accounts are generally protected from the claims of creditors. Most employer-sponsored pension plans are protected from creditors through the federal Employee Retirement Income Security Act of 1974 (ERISA).

INSURANCE COVERAGE

Insurance policies can serve as a first line of defense against legal claims. Some types of insurance are required under Massachusetts law, but other policies may be advisable. The type of insurance policies and extent of coverage that is advisable will depend on, among other things, the value of the assets that are to be insured; the size and nature of the business; and whether the business has employees. In addition, umbrella insurance policies can supplement another insurance policy when claims exceed that underlying policy's coverage limit. The point of having insurance coverage is to pay a premium you can afford to transfer a risk you cannot afford. As part of comprehensive asset protection, business owners need to not only ensure that their insurance coverage is calibrated to their current needs and risk tolerance, but also understand both the risks they have retained and the risks they have transferred.

DATA SECURITY

Data breaches have supplanted traditional 'slip and fall' lawsuits as a business owner's worst legal nightmare. Technological loopholes and human error can increase the risk of theft and loss of digital business assets including customer data, banking passwords, employee records, and proprietary information. Business owners should secure their digital assets to prevent embarrassing and expensive data breaches. A comprehensive asset protection plan should incorporate data security strategies.



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